



June 29, 1966

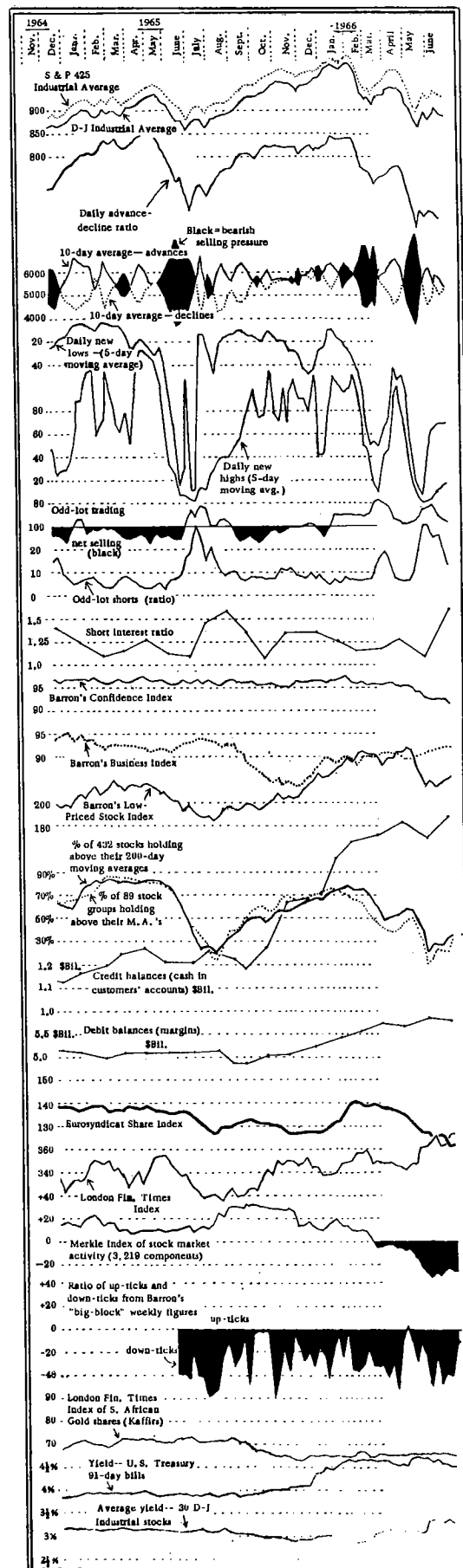
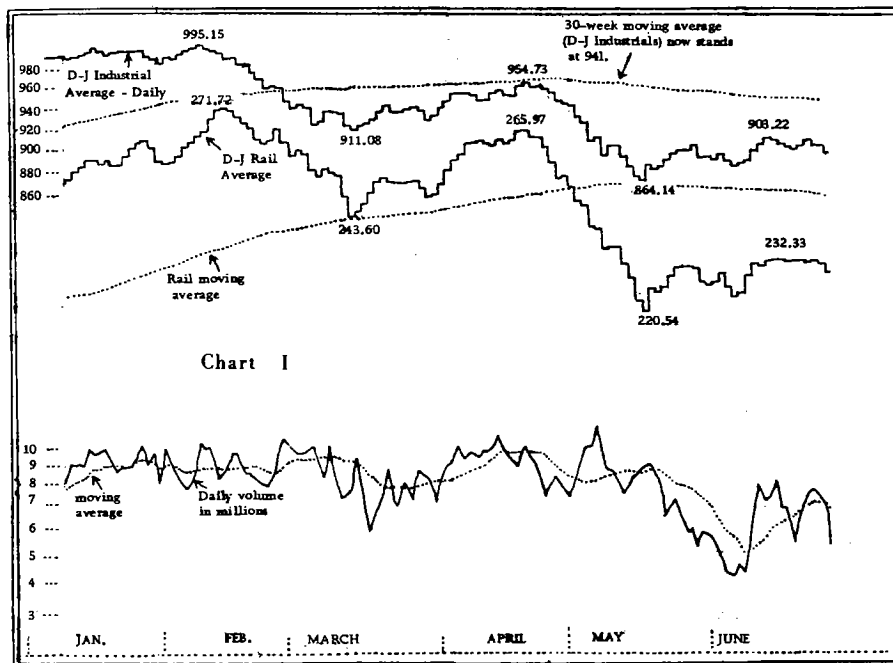
Letter 327

THE MARKET: Never before in our nation's history has a serious war developed during a period of economic boom. But it has happened now. The result is mass confusion, both within the American society and the American economy. Much of this confusion is reflected in what Wall Street is doing and what Wall Street is saying. The war has split political parties and it is going to have a marked effect on voters. Uncertainty is the order of the day.

Even before the current huge Vietnam buildup, it was obvious that the great bull market which began in 1949 was nearing senility (it was by far the oldest bull market in history). One gauge of the bull market's age was the "tired" action of many of the blue-chip stocks, the same stocks which for years had led the Averages to new high ground. But with the advent of war, money has become increasingly scarce and interest rates have risen to the highest level in a generation. High interest rates and economic booms have never made happy bedfellows. A second development to grow out of the war is the probability (now almost a certainty) that taxes will have to be boosted. Taxes will be raised (not for anti-inflation purposes as our President piously hints), but because our Government sorely needs the money. Aside from the age of the bull market alone, these two factors, tight money and rising taxes, have cast a pall over Wall Street.

In the face of this, confusion is heightened by the torrid state of the war-spurred economy. And final perplexity is provided by the appearance of a few soft spots in the non-military sectors of the economy, namely a downturn in auto sales and a sharp slump in housing. With the economic statistics amenable to either a bullish or bearish interpretation and with the stock market Averages fluctuating within "secondary territory" (i.e. above the May lows but well under the February highs), the stage is set for a battle of the analysts. In the end, however, it is not the analysts but the market itself which will provide the verdict.

As far as Dow's Theory is concerned, we are currently engaged in a secondary (upward) movement within a primary bear trend. This means that the major direction of the market is down, and that all rallies are corrections against the



prevailing major bearish forces. To put it another way, Dow's Theory now considers the "natural" direction of the market to be down, and all advances must therefore be considered as suspensions of the prevailing bear trend. As a rule, the most convincing market action occurs in the direction of the primary trend, and this is the reason I have been writing so extensively about the quality of this most recent rally.

For instance, it is not normal for leading blue-chip stocks such as General Motors, Chrysler, Johns Manville, Standard Oil of California, Standard of Jersey, Texaco, Woolworth, General Food, etc., to break to new lows during a rally. It is not normal during a bull market rally for the Utility Average and the D-J 40 Bond Average to break to three-year lows together. It is not normal during a bull rally for new lows persistently to outpace new highs. This type of "leakage" is the sort of thing I would expect during a rally in a bear market. It is sour upside action, and I consider it bearish.

The current bear market rally started on May 17 at 864.14 for Industrial, 220.54 for Rails. The high for the rally (so far) was struck by Industrials on June 14 when that Average touched 903.22. Perhaps significantly, the high for the advance-decline ratio was established on May 27, only eight days after the May 17 low. Rails have been moving sideways for the past 11 days, having formed a tight little range in the 231-232 area. Finally, Utilities have been sinking to new lows almost daily, and they are now at their lowest level since the first quarter of 1963. What are the guideposts to watch? On the upside, a breakout by Industrials and Rails above 903.22 and 232.33 respectively would suggest a further extension of the rally. Conversely, a breakdown of the two Averages with Industrials dropping into 890 area and Rails falling into the 230 area (on increasing volume) would provide strong evidence that the rally had exhausted itself and that the bear forces were again gaining control.

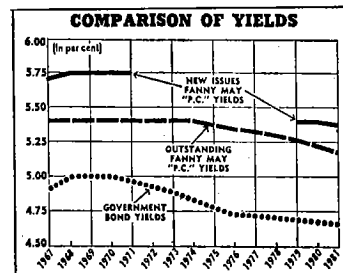
The Average have been diverging in direction since June 13. It is a remarkable fact that on eight of the ten trading days (!) since June 13, divergence has occurred with either Rails or Industrials closing up while the other Averages closed down. Often, a series of divergent days following a rally (or a decline) will signal an imminent change of direction for the market. If so, it is possible that the extraordinary series of divergent closings since June 13 is providing evidence of a coming end to the rally.

Another noteworthy phenomenon of recent weeks is the divergence between the Industrial Average and the advance-decline ratio. The A-D ratio recorded a rally peak on May 27 with Industrials at 897.04. A decline followed, and a new rally recorded a lower peak for the A-D ratio on June 14 (Industrials were 903.22). Another decline ensued and a third rally established a still lower peak for the A-D ratio on June 22. Thus the A-D ratio has, since May 27, built a series of descending peaks even while the Industrials have been recording successive highs. Such "out-of-gear" movements between Industrials and the A-D ratio have, in the past, been the forerunners of important reversals to the downside. Therefore, unless the A-D ratio can produce a burst of strength in the period ahead, I would say that the breadth-price relationship is shaping up as bearish for the market (a final Industrial high above 903.22, unconfirmed by the A-D ratio, would complete a full "triple-divergence" for Industrials and the A-D ratio, and such a development would be particularly bearish).

NOTES & QUOTES: A few weeks ago the first of the new so-called "Participation Certificates" (P.C.'s) were sold for the U.S. Government through the facilities of the Agency known as the Federal National Mortgage Association. This first parcel of \$530 million of P.C.'s represents part of \$11 billion of assorted Government loans which (for bookkeeping purposes) the U.S. is selling to the public. The P.C.'s do not specifically carry the "full faith and credit" of the U.S. Government, "but in effect they do carry a Federal guarantee. They are guaranteed by the Fed. Nat. Mortgage Assoc., and this agency has the power to make "indefinite and unlimited" borrowings from the Treasury to pay interest or principal on the P.C.'s.

The P.C.'s falling due in 1967 were priced to yield 5.7%, and those maturing in 1968 to 1971 yielded 5.75%. The P.C.'s were sold in denominations of \$5 thousand and up, they will pay interest twice a year, and they can be purchased through such participating firms as Merrill, Lynch or First Boston Corp. I have included a chart which compares current yields for three categories of Government-guaranteed or Government agency-guaranteed debt. Note that the new P.C.'s have pushed the interest ceiling to a new high of 5.75%, approximately 3/4's of a percentage point above Government bonds of comparable maturities.

What do I think of purchasing the new P.C.'s? Well, certainly one-year Government agency-guaranteed paper yielding 5.7% is attractive. I do not like to put all my eggs in one basket, but I see nothing wrong with putting up to say 20% of one's assets in the new P.C.'s maturing in 1967. Why wouldn't I put more than 20% of my assets in the P.C.'s? Because it is probable that many even more attractive and higher-yielding vehicles will appear in the next six months to a year.



Bear markets are painful, and as I wrote in Letter 323, "one result is going to be questions and soul-searching by the American people." Along these lines, I was particularly interested in a large advertisement which appeared in the June 12 issue of the *New York Times*. The ad was sponsored by the "AT & T Shareowners Committee of 100,000" and was an angry invitation to AT & T owners to "have a voice in the FCC hearings." The FCC, of course, is preparing an investigation of "Mother Bell," and the Committee and the stockholders are now blaming the FCC for driving Telephone down from its old high of 75 to a recent low of 52. Whether the FCC investigation has driven Telephone down is a matter of debate, but what is sure is that the drop in Telephone has already wiped out \$6.7 billion in values. That staggering figure gives us some idea of what it means when the Dow Industrials start sliding during a bear market. But what about the new lows in Texaco, General Motors, Standard Oil of California, Jersey, DuPont, GM, International Paper, General Foods, Woolworth, etc.? Who's going to represent all those stockholders? Time will tell.

Last week President Johnson again reaffirmed his purpose to carry on in Vietnam, and to step up our troop commitment there as the need arises. Here are a few important quotes regarding Vietnam, the first by Max Frankel in the May 22 *New York Times*: "All of us, on all sides of the issue, now sense the good-natured ignorance with which we entered upon this fateful mess. We dimly recall calculations of self-interest that gave rise to noble but blind ambition, then investments of hope and treasure and honor and blood, each to redeem the others until each became a purpose unto itself."

"What we are beginning to sense, of course, is tragedy: the inexorable yet continually surprising march of incidents, evoking almost predictable responses, driving the drama along. Aid to sustain the land. Weapons to guard the land. Advisers to demonstrate the weapons. Helicopters to bear the advisers. Troops to guard the helicopters. Planes to protect the troops. More troops to build the bases. Still more troops to defend the builders. Shoot when shot at. Shoot to keep from being shot at. Shoot to protect. Shoot to destroy. Bomb to kill. Kill."

The second is from Joseph Kraft's article (Joe was an old high school pal of mine, and he is becoming one of the top syndicated writers in the nation) from the *New York Review of Books* June 23: "It would seem, then, that the highest American officials really believe that the future lies with Marshal Ky, and that, accordingly, they have done all they could to prop him up. This may well be the case, but I do not think so. On the contrary, I believe that the American position has not been the result of a deliberate policy but of the absence of one. . . . Perhaps there is no way of changing this attitude. And if so, the U.S. will be tied to a government that can neither fight the war nor negotiate a peace. The President will have no alternative but to throw in even more men and planes." (Joe is just back from a long stay in Vietnam).

Worried about the drop in your AT&T stock?

This is what you can do.

Ever since the Federal Communications Commission announced an investigation of American Telephone and Telegraph Company's rates and profits, the company's stock has steadily slid. Despite rumors by AT&T managers that the proposed coming hearings before the Federal Communications Commission were unnecessary and damaging, the Commission has refused to change its plans. Ahead lie three to five years of expense and even productive work by many of your company executives.

Practical method by which individuals can make known their needs, their ideas and their opinions. By joining the AT&T Shareowners Committee of 100,000, you will have a voice in the FCC hearings and as a member you will receive regular reports of the Committee's activities and status of receipts and expenditures. By putting up money to protect your investment, you will help build an organization which will represent your views. Your check—made out to "The AT&T

Whenever I write a very short-term review (as exemplified by the three preceeding paragraphs above) I do so with trepidation, since the whole market picture can change so rapidly, perhaps between the time the Letter is printed and the time the Letter is mailed (the following morning). Yet I feel that such comments are valuable if for no other reason than that subscribers can see what I am watching and thereby learn to watch such manifestations and developments for themselves.

As a last comment for this section, I note that the June 27 issue of Barron's provides two incongruous technical statistics. The short interest ratio in June rose to 1.59, a level which might ordinarily be construed as bullish (see comments in the last Letter). At the same time, the Confidence Index continued its drop, sinking to 91.1, the lowest level since 1963. Bulls and bears both have fodder to chew on here.

GOLD: "Gold stocks," writes Mr. Alden Wells in his latest Monetary Report, "can increase in value only when the U.S. Government is headed towards domestic bankruptcy, and defense stocks when the Administration is headed towards bankruptcy in foreign affairs. . . . The market has marked this ultimate irony that from the day Kennedy-Johnson took office, gold stocks and defense stocks outpaced industrial and financial stocks."

The fundamentals of international finance seem forgotten today amid the mass of gimmickry and financial legerdemain which characterizes our nation. We might remember, however, that for thousands of years the accumulation of real wealth by a nation has been measured by a rise in its gold reserves while a march towards bankruptcy has been gauged by falling gold reserves. When a nation spends more than it takes in (an indication of inefficiency or profligacy) or when a nation overextends itself (an indication of a flight from reality), the result is a deterioration in the value of its money and an ultimate exodus by this money into the safety of gold. The spendthrift nation then invariably takes the next step, which is an attempt to "free" its bastardized currency completely from the discipline of gold. The spendthrift nation's politicians will decry the "tyranny of the yellow metal," but such pious denunciations serve only to stir up greater fears in the hearts of the wealth producers and savers. The producers and savers will then seek to protect themselves further. The intensity of their fears can be measured by the rise or fall in the price of gold (and gold shares).

The reserve currencies (dollars and pounds) are now in the hands of the two spendthrift nations of the Western world, Britain and the U.S. The former, after suffering decades of inflation and inefficient socialism, is now the sick man (should we say sick midget) of the West. Tottering in the face of a series of international "rescue operations," once-mighty Britian has lost much of its power and most of its influence. Britain has become a satellite of one of its former colonies, the U.S. And the U.S. itself has become a prisoner of a disastrous series of misguided economic and foreign policies. For this reason, the dollar is losing its once impregnable status; its value as a holding is being seriously questioned by thinking men around the world.

One protection against an ultimate collapse (devaluation) of the dollar is ownership of some strong foreign currency such as the French franc. Another protection against a devaluation is an interest in the shares of a legitimate gold mine. Should the price of gold be raised in terms of dollars, then the resultant profit to gold mining firms (which would receive an overnight boost in the price of their product) would immediately be reflected in the rising price of their shares. Such an increase in the price of gold shares, it is hoped, would offset any loss sustained in the lowered value of dollars held.

There seems to be a good deal of confusion regarding the effect which devaluation might have on U.S. citizens. Theoretically, a devaluation should make little difference to the average citizen. The one sphere in which the effect of devaluation might be immediately apparent would be in the price of foreign merchandise. In a devaluation foreign goods would rise in price and consequently be of less interest to U.S. citizens. Conversely, a U.S. devaluation would mean that U.S. merchandise would be more attractively priced for those hard-currency nations which had resisted devaluing their own currencies.

However, one thing is fairly clear. The chances of a unilateral or even a U.S.-British devaluation is slim. The more likely possibility would be a multi-lateral raising of the price of gold, with a resultant boosting of the value of gold reserves throughout the world. This, of course, would lay the groundwork for an ultimate new round of inflation based on the new (higher) level of gold reserves of all gold-holding nations. That many nations are now betting on such a possibility is obvious from even a cursory examination of the trend of their gold reserves (which are constantly rising). These nations are very simply taking a speculative "long position" in gold.

It is of interest that the recent 35% devaluation of the Indian rupee was preceded by denials from successive finance ministers, and this devaluation was opposed by every member of the Indian cabinet. The much-denied devaluation caught everybody by surprise, and it was thought that it would only come after the next Indian election. Devaluations always come after repeated denials. It's the nature of the beast.

I have, in the past, and continue now to recommend a 10% to 15% position in selected gold shares as protection against our Government's profligate policies. In the Western hemisphere I would recommend Dome Mines as a good holding. Dome controls 63% of Sigma Mines and 57% of Campbell Red Lake. Dome (as with most Western gold stocks) has a small capitalization of only 2 million shares. Dome rose from 2 in 1918 to a historic high of 34 in 1938, following the 1933 devaluation. DM dropped to 8 in 1942, following which a massive build-up began. By 1963 DM had risen to 33, still a point below its 1938 peak. In 1964 DM finally bettered the old 1938 peak, and the stock probably then began to discount the next potential devaluation. The 1965 peak for DM was 42, after which a new consolidation occurred. Last month DM rose to an historic high of 47 $\frac{1}{4}$. Over the past few weeks DM again backed off into the low 40 area. I consider DM a "buy" on all dips into the 41-44 area.

As to the big South African gold mines, I have recommended and continue to recommend American-South African Investment Trust, President Brand, Western Deep Level B, West Areas, Free State Geduld and West Driefontien for new purchases. All of these can be purchased via American Depository Receipts, and all are quoted in the Foreign Securities section of the Wall Street Journal.

Latest news on much-recommended Western Deep (WD) is that the B stock will begin paying dividends in June. WD increased the dividend on the A shares from 27¢ to 37¢. Earnings in 1965 rose 57% from 1964 with a 14% increase in tons milled. Free State (FS) showed a 5.5% rise in profits during 1965 and the dividend was raised from \$1.33 to \$1.53. The major part of FS's property is still untapped, and the dividends from its 50% ownership of Freddie's Cons. mine assure it steadily rising profits in the years ahead. President Brand (PB) has increased its dividends from 88¢ to 91¢. Net profit rose 5% for the first six months of fiscal 1966, and the recent acquisition of Free State Saaiplass mine will increase PB's capacity and earnings. West Driefontien, Africa's largest gold producer, showed a working profit rise of 14% for the year ending June, 1965. Dividends were increased to 95¢ from 83¢, and this stock has recently risen to an all-time high. Conclusion: any or all of the gold shares mentioned here are suitable for inclusion in subscribers' portfolios.

LATE NOTES: (Written Tuesday, June 28, after the opening)...Yesterday, like the black specter in a recurrent nightmare, the bear reappeared. It was not a pretty sight. Industrials dropped 8 points, Rails broke below their little 2-point range of the past 11 days, while Utilities sank to a new three year low. There was no news to account for the "unexpected" decline.

The decline was led by the "high flyers" with the Airlines and Electronics dotting "the most active" list. Also leading the way on the downside (on the most active list) were three Dow stocks, Standard Oil of New Jersey, Chrysler and American Telephone. Most of the Color-TV stocks have now completed their (head-and-shoulder) distribution formations (see Letter 325), and Motorola has been the first of the Color-TV leader to crack wide open. The Airlines, the only group on the Board which is producing many daily new highs, could be the next to go. If the market slides badly, I do not believe the Airlines will even produce distribution formations. They could simply go into "one-day reversals" and start diving.

What do we watch now? The halfway level of the entire May-June rally for Industrials (864.14 to 903.22, see chart 1) is 883.68. If Industrials break that halfway level, my guess would be that the "summer rally" is over, and that the bear again has his teeth in the throat of the dying bull. Once again I want to warn my subscribers; this is a very deceptive and dangerous bear market. Do not try to "ride it out." In Letter 323 I presented my case for believing that this decline could take the Dow to the 645-700 level. Already the losses in some stocks such as Telephone, Stand. of Jersey, Stand. of Calif. are very large. If the Dow approaches anything like 700 on the downside the losses will be frightening. A breaking of the 1966 lows of 864.14 and 220.54 would almost certainly mark the beginning of a panic. Therefore, I once again implore my subscribers to get into a cash (Treasury bill) position and protect themselves against the coming ravages of the bear market. Yes, the trouble could be starting again now, and it could last through the summer. Don't "partially avoid it" by selling a few shares. Sell out and get ready for trouble now and great investment opportunities further ahead.

At right (courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kan.) are weekly charts of two of the strongest stocks on the Board. Every subscribers should have a few shares of these, and it is not too late to buy them now. If you own no gold shares, you might, at this state of the game, place 5% of your assets in these two stocks (equally divided).

News clips of the week. These four items all appeared in the Wall Street Journal within the space of four days!

New York Savings Bank To Boost Rate to 4.60% On Regular Accounts

Bank for Savings Currently Pays 4.50%; Rate on 'Term Accounts' To Increase to 5% From 4.60%

By a WALL STREET JOURNAL Staff Reporter
NEW YORK—New York Bank for Savings, a large mutual savings bank here, said it will pay 4.60% on all regular savings accounts beginning July 1. It will also offer a special rate of 5% on "term accounts" starting July 1.

Agency Formally Lets S&Ls in 2 States Pay 5.5% on Some Accounts

Home Loan Bank Board Permits New Top Rate in California, Nevada for Funds Held 3 Years

A WALL STREET JOURNAL News Roundup
The Federal Home Loan Bank Board in Washington decided to let California and Nevada savings and loan associations pay up to 5.5% annual interest on certain "bonus" ac-

Instalment-Loan Rates Boosted by 4 Big Banks In New York City Area

Rise of 50 Cents per \$100 Made by First National City, 3 Others In Wake of Chase Bank Move

By a WALL STREET JOURNAL Staff Reporter
NEW YORK—First National City Bank and three other major New York metropolitan area banks increased their rates on automobile and other types of instalment loans by 50 cents per \$100 a year. They moved in the wake of a similar step Wednesday by Chase Manhattan Bank, the largest bank in New York City.

Thrift institutions, battling with commercial banks for savers' dollars, continued to raise their dividend rates. Dime Savings Bank of Brooklyn became the second New York savings bank to increase its annual dividend rate on regular savings to 5% from 4½%, effective July 1. In Los Angeles, Lytton Savings & Loan Association joined Home Savings in offering 5¼% on regular savings and 5¾% on bonus accounts.

